Daiwa Capital Markets

U.S. Economic Comment

- Fiscal prospects: more support likely, despite stirring in inflation expectations

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Biden to the Rescue?

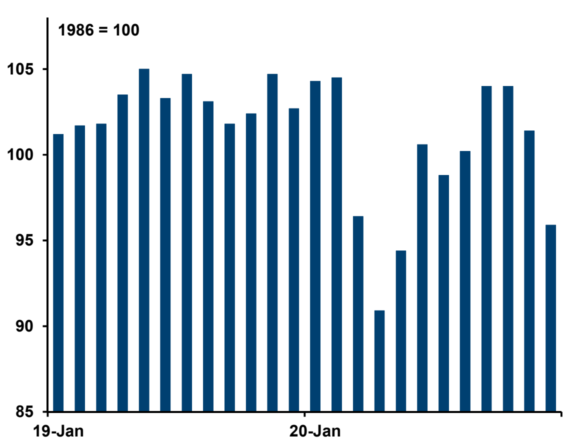
In a week filled with important data releases, President-Elect Biden captured center stage with his proposal to provide $1.9 trillion of fiscal stimulus to be added to the $900 billion approved by Congress in December. The magnitude of the Biden proposal is ambitious when viewed in isolation; it is striking when combined with the December legislation. Its size and some of the components will be resisted by Republicans, and thus the bill is not likely to sail through Congress. Nevertheless, we suspect that a substantial portion of the proposal will be approved by the Democratic Congress.

Two developments this week boosted the likelihood of additional stimulus. First, news accounts relating to vaccine distribution were uniformly negative. The Biden plan includes $160 billion to promote Covid testing and vaccine distribution; it is difficult to imagine many legislators challenging efforts to speed distribution.

Second, some of the economic reports this week involved soft results, suggesting that the economy needs an additional push. Initial claims for unemployment insurance jumped in the latest week, with the new total close to one million individuals. The number of individuals receiving unemployment benefits also rose. In addition, the small-business sentiment index published by the National Federation of Independent Business showed a marked decline in December (chart, left). This measure does not receive close attention in financial markets, but given that it provides insight into the at-risk small-business community, it is relevant.

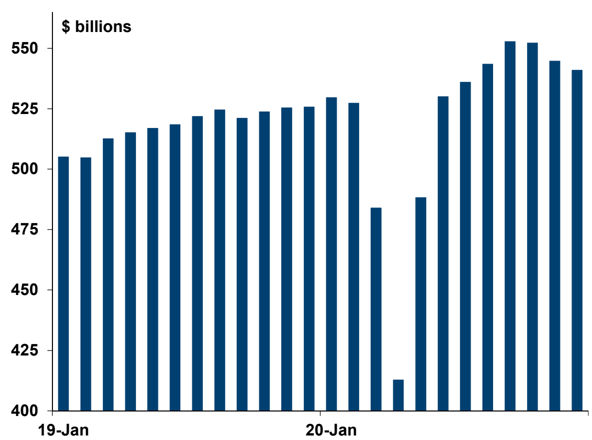
The report on retail sales for December, which showed a third consecutive monthly decline, will probably capture most of the attention in the media and stir calls for additional support. This report certainly had a soft tone, but we did not find it alarming. Recall that household spending surged during the summer months in response to the stimulus provided by the Cares Act. Some payback for that burst was likely at some point. Even with the three consecutive declines, sales are comfortably above their pre-pandemic levels (chart, right). Nevertheless, most observers will view the report as troubling, and many will use the results to support the case for additional fiscal stimulus.

Small Business Optimism Index



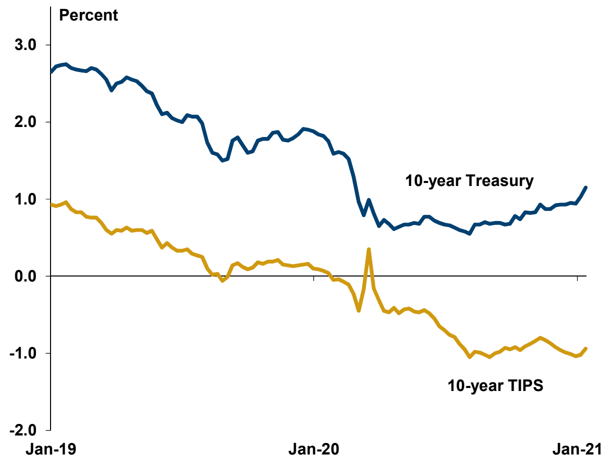
Source: National Federation of Independent Business via Haver Analytics

Retail Sales



Source: U.S. Census Bureau via Haver Analytics

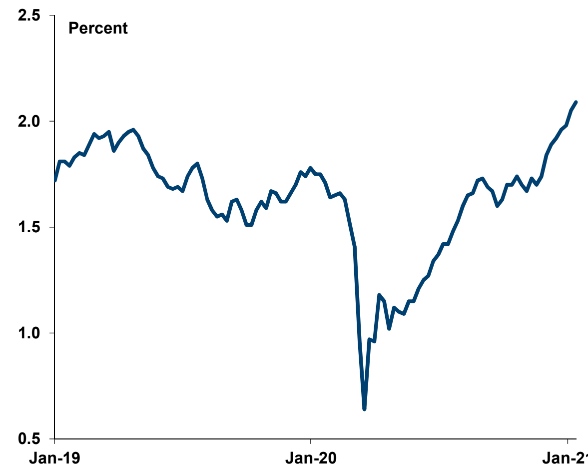
10-Year Interest Rates*



** Weekly average data. The last observations are daily readings for January 14, 2021.*

Source: Federal Reserve Board via Haver Analytics

10-Year Break-Even Inflation Rate*



** The rate on 10-year nominal Treasury securities less the rate on 10-year TIPS. Weekly average data. The last observation is a daily reading for January 14, 2021.*

Source: Federal Reserve Board via Haver Analytics

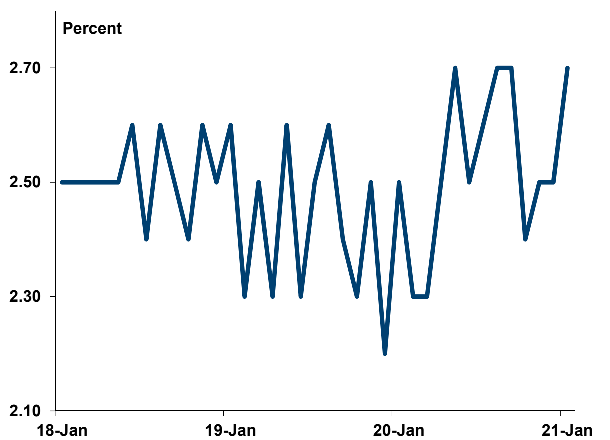
Deficits, Debts, Inflation: Possible Hurdles

Some legislators might oppose additional stimulus because of the effects on an already sizeable budget deficit and federal debt. However, such concern is not widespread among members of Congress. Market participants also do not seem deeply concerned, as interest rates eased on Friday after the Thursday night announcement from President-Elect Biden.

Although not concerned about deficits, some market participants seem to be thinking about a pickup in inflation. Longer-term interest rates have drifted higher since August, with the rate on 10-year Treasury notes moving from 0.55 percent more than 1.0 percent this week. Inflation expectations seem to be the driver behind the change. Rates on Treasury inflation protected securities, which can be viewed as a real interest rate, have been essentially steady until recently. The spread between nominal and inflation-protected securities could be viewed as a measure of inflation expectations, and it is now at the top of the range seen in the past few years (charts, above).

We would not push such measures of inflation compensation too hard because liquidity and risk considerations can lead to shifts unrelated to the inflation outlook. However, some survey measures of

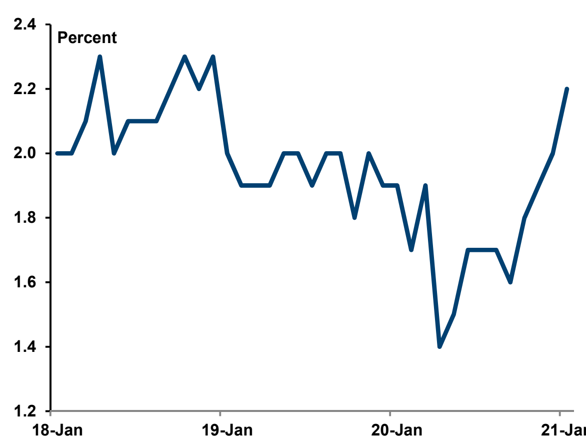
Long-Term Inflation Expectations*



** The expected average yearly change in prices over the next five to 10 years.*

Source: University of Michigan Survey Research Center via Haver Analytics

Business Inflation Expectations*



** The expected change in unit costs over the next 12 months. Mean estimate.*

Source: Business Inflation Expectations Survey, Federal Reserve Bank of Atlanta via Haver Analytics inflation expectations also are stirring. The surveys of consumers conducted by the Conference Board and the University of Michigan Survey Research Center include measures of expected inflation, and both have picked up this year. The Federal Reserve Bank of Atlanta conducts a survey of business executives, and this report also shows a stirring in expected inflation (charts, prior page, bottom).

The apparent shifts in expectations have not been large enough to suggest that problems are on the horizon. In fact, Fed officials might welcome the pickup, as some policymakers were worried that below-target inflation in the past several years could lead to a drop in inflation expectations.

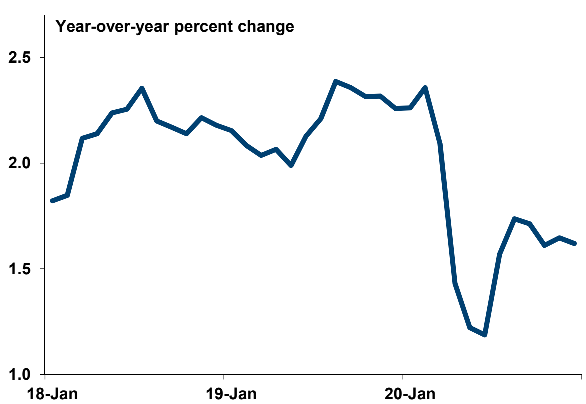
The stirring in inflation expectations might seem strange in light of subdued results in recent measures of inflation. For example, the year-over-year core CPI has been in the range of 1.6 to 1.7 percent in the past six months, down from a range centered in 2¼ percent in most of 2018 and 2019 (chart, left).

One wonders, though, whether the deceleration will be long lasting. The detail of the CPI report shows that much of the restraint has occurred in items sensitive to the weak demand generated by the pandemic. For example, a weighted average of airfares, hotel fees, and apparel prices has declined approximately 13 percent from the pre-Covid average in January/February (chart, right; the chart shows a weighted average of the index levels for these items rather than the percent change; the scale on the vertical axis could be viewed as a representative price for these goods or services).

Other virus-related effects also might be at work. Rental rates for apartments and homes, although still increasing, are advancing at a much slower rate than previously. Monthly increases of 0.3 percent were common before the virus hit, but they have been in the neighborhood of 0.1 percent in five of the past seven months. A preference for homeownership rather than clustered living in a city is likely the driving force. Interestingly, the cost of medical care has declined for three consecutive months, perhaps a lagged response to a drop in elective procedures during the pandemic.

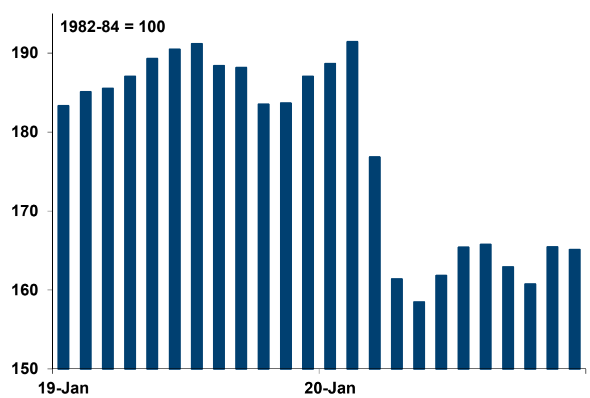
A reversal of these shifts would quicken the inflation rate, possibly pushing it above the 2¼ percent seen before the pandemic. Such a burst would probably be temporary, but a fundamental shift cannot be dismissed. Mainstream models of price dynamics typically contain three key drivers of inflation: economic slack, inflation expectations, and idiosyncratic factors, such as energy prices and import prices. Economic slack has had little influence on price pressure in recent years, which leaves expectations and idiosyncratic factors as likely to be shaping the path of inflation once the economy is back on solid ground. Expectations are beginning to stir, and the softening in the foreign exchange value of the dollar this year suggests that import prices will be rising.

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

CPI: Pandemic-Sensitive Areas*



** A weighted average of the Apparel, Airline Fare, and Lodging Away From Home components of the CPI. Weights are calculated based on the relative importance of each component in the CPI.*

Source: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Review

Week of Jan. 11, 2021	Actual	Consensus	Comments
CPI (December)	**0.4% Total, 0.1% Core**	**0.4% Total, 0.1% Core**	Most of the pressure in the headline CPI in December was the result of an increase of 4.0% in energy prices. The food component also contributed to the above-average advance in the headline index with an increase of 0.4%. The core component posted another subdued increase, with areas affected by the virus (airfares, hotel fees, apparel prices) providing restraint.
Federal Budget (December)	**$143.6 Billion Deficit**	**$143.5 Billion Deficit**	Revenues in December were 3.1% firmer than the total in the same month last year, a better showing than the average decline of 2.8% in the first two months of the current fiscal year. Outlays surged 40.3% on a year-over-year basis, partly because of continued fiscal support but also because of a calendar configuration that pulled a portion of the January Social Security payment into December. The cumulative deficit of $573 billion in the first three months of FY2021 is approximately $216 billion wider than the results in the same period in FY2020.
Retail Sales (December)	**-0.7% Total, -1.4% Ex-Autos**	**0.0% Total, -0.2% Ex-Autos**	Retail sales fell for a third consecutive month, with the cumulative change totaling 2.1%. Much of the weakness can be viewed as an offset to unusual strength during the summer when fiscal support stirred activity and drove sales well above the underlying trend. At the same time, the report carried some signs of emerging weakness, which is a concern at a time when the virus remains widespread and the distribution of vaccines is proceeding slowly.
PPI (December)	**0.3% Total, 0.1% Ex-Food and Energy**	**0.4% Total, 0.2% Ex-Food and Energy**	The increase in the PPI in December was led by a jump of 5.5% in energy prices. Food prices, in contrast, slipped 0.1%. Prices excluding food and energy continued their recent tame performance, with monthly increases of 0.1% in each of the past three months. On a year-over-year basis, growth in prices excluding food and energy slowed 0.2 percentage point to 1.2%. The headline index has increased 0.8% in the past year, restrained by a drop of 7.1% in energy prices.
Industrial Production (December)	**1.6%**	**0.5%**	A portion of the jump in industrial production in December was the result of a surge of 6.2% in utility output, which almost always reflects swings in temperature rather than economic fundamentals, but other keys areas also performed well. The manufacturing sector increased 0.9%. Manufacturing output has now advanced for eight consecutive months and regained 87% of the ground lost in the spring. Mining activity (up 1.6%), which was hurt by a drop in crude oil prices earlier in the year, showed continued signs of recovery with the fifth gain in the past seven months.
Consumer Sentiment (January)	**79.2 (-1.5 Index Pts.)**	**79.5 (-1.2 Index Pts.)**	Consumer sentiment slipped 1.9% in Early January. The change was not especially large, but it was telling in that moods slipped despite a strong performance in the stock market. The drop suggests that the virus is dominating the thoughts of individuals.

Sources: Bureau of Labor Statistics (CPI, PPI); U.S. Treasury Department (Federal Budget); U.S. Census Bureau (Retail Sales); Federal Reserve Board (Industrial Production); University of Michigan survey Research Center (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of Jan. 18, 2021	Projected	Comments
Housing Starts (December) (Thursday)	**1.550 Million (+0.2%)**	A drop in sales of new homes in November (off 11.0%) is likely to lead builders to slow the pace of single-family starts from the robust performance in November, which was the best month in more than 13 years and 33% above the average from 2019. Multi-family starts could provide an offset to the expected easing in single-family activity, as permits jumped in November.
Existing Home Sales (December) (Friday)	**6.55 Million (-2.1%)**	Three consecutive declines in pending home sales suggest that the frenetic pace of sales from September through November will ease in the final month of the year. The expected pace of sales, although off on a month-to-month basis, is still firm by recent standards: 18.5% above the total from 2017, which was the best year of the previous expansion for existing home sales.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

January/February 2021

Monday 11

Tuesday 12

NFIB SMALL BUSINESS OPTIMISM INDEX

Oct	104.0
Nov	101.4
Dec	95.9

JOLTS DATA

	Openings (000)	Quit Rate
Sept	6,494	2.2%
Oct	6,632	2.2%
Nov	6,527	2.2%

Wednesday 13

CPI

	Total	Core
Oct	0.0%	0.0%
Nov	0.2%	0.2%
Dec	0.4%	0.1%

FEDERAL BUDGET

	2020	2019
Oct	-$284.1B	-$134.5B
Nov	-$145.3B	-$208.8B
Dec	-$143.6B	-$13.3B

JANUARY BEIGE BOOK

"Most Federal Reserve Districts reported that economic activity increased modestly since the previous Beige Book period, although conditions remained varied: two Districts reported little or no change in activity, while two others noted a decline."

Thursday 14

UNEMPLOYMENT CLAIMS

	Initial	Continuing (Millions)
Dec 19	0.806	5.198
Dec 26	0.782	5.072
Jan 02	0.784	5.271
Jan 09	0.965	N/A

IMPORT/EXPORT PRICES

	Non-petrol. Imports	Nonagri. Exports
Oct	-0.1%	-0.2%
Nov	0.0%	0.3%
Dec	0.4%	1.3%

Friday 15

RETAIL SALES

	Total	Ex.Autos
Oct	-0.1%	-0.2%
Nov	-1.4%	-1.3%
Dec	-0.7%	-1.4%

PPI

	Total	Ex. Food & Energy
Oct	0.3%	0.1%
Nov	0.1%	0.1%
Dec	0.3%	0.1%

EMPIRE MFG

Nov	6.3
Dec	4.9
Jan	3.5

IP & CAP-U

	IP	Cap.Util.
Oct	1.0%	73.0%
Nov	0.5%	73.4%
Dec	1.6%	74.5%

CONSUMER SENTIMENT

Nov	76.9
Dec	80.7
Jan	79.2

BUSINESS INVENTORIES

	Inventories	Sales
Sept	0.8%	0.9%
Oct	0.8%	0.9%
Nov	0.5%	-0.1%

Monday 18

MARTIN LUTHER KING JR DAY

Tuesday 19

TIC DATA (4:00)

	Total	Net L-T
Sept	-$80.5B	$108.9B
Oct	-$10.4B	$51.9B
Nov	--	--

Wednesday 20

NAHB HOUSING INDEX (10:00)

Nov	90
Dec	86
Jan	--

Thursday 21

INITIAL CLAIMS (8:30)

HOUSING STARTS (8:30)

Oct	1.528 million
Nov	1.547 million
Dec	**1.550 million**

PHILLY FED INDEX (8:30)

Nov	20.7
Dec	9.1
Jan	--

Friday 22

EXISTING HOME SALES (10:00)

Oct	6.86 million
Nov	6.69 million
Dec	**6.55 million**

Monday 25

CHICAGO FED NATIONAL ACTIVITY INDEX

Tuesday 26

FHFA HOME PRICE INDEX

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX

CONSUMER CONFIDENCE

FOMC MEETING

Wednesday 27

DURABLE GOODS ORDERS

FOMC DECISION

Thursday 28

INITIAL CLAIMS

GDP

U.S. INTERNATIONAL TRADE IN GOODS

ADVANCE INVENTORIES

NEW HOME SALES

LEADING INDEX

Friday 29

PERSONAL INCOME, CONSUMPTION, PRICE INDEXES

EMPLOYMENT COST INDEX

MNI CHICAGO REPORT

PENDING HOME SALES

REVISED CONSUMER SENTIMENT

Monday 1

ISM MFG INDEX

CONSTRUCTION SPEND.

Tuesday 2

NEW VEHICLE SALES

Wednesday 3

ADP EMPLOYMENT REPORT

ISM SERVICES INDEX

Thursday 4

INITIAL CLAIMS

PRODUCTIVITY & COSTS

FACTORY ORDERS

Friday 5

EMPLOYMENT REPORT

TRADE BALANCE

CONSUMER CREDIT

Forecasts in Bold.)

Treasury Financing

January/February 2021

Monday	Tuesday	Wednesday	Thursday	Friday
11	12	13	14	15
AUCTION RESULTS: Rate Cover 13-week bills 0.090% 2.92 26-week bills 0.090% 3.29 3-year notes 0.234% 2.52	**AUCTION RESULTS:** Rate Cover 10-yr notes 1.164% 2.47 42-day CMB 0.085% 3.18 119-day CMB 0.090% 3.61 **ANNOUNCE:** $30 billion 4-week bills for auction on January 14 $35 billion 8-week bills for auction on January 14 $25 billion 105-day CMBs for auction on January 13 $30 billion 154-day CMBs for auction on January 13 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION RESULTS:** Rate Cover 30-yr bonds 1.825% 2.47 105-day CMB 0.090% 3.84 154-day CMB 0.090% 3.62	**AUCTION RESULTS:** Rate Cover 4-week bills 0.075% 3.62 8-week bills 0.080% 3.23 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on January 19 $24 billion 20-year bonds for auction on January 20 $15 billion 10-year TIPS for auction on January 21 $30 billion 42-day CMBs for auction on January 19 $30 billion 119-day CMBs for auction on January 19 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	**SETTLE:** $58 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds
18	19	20	21	22
MARTIN LUTHER KING JR DAY	**AUCTION:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on January 21 $35 billion* 8-week bills for auction on January 21 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION:** $24 billion 20-year bonds	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $15 billion 10-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction January 25 $34 billion* 52-week bills for auction on January 26 $28 billion* 2-year FRNs for auction on January 27 $60 billion* 2-year notes for auction on January 25 $61 billion* 5-year notes for auction on January 26 $62 billion* 7-year notes for auction on January 28 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
25	26	27	28	29
AUCTION: $105 billion* 13-,26-week bills $60 billion* 2-year notes	**AUCTION:** $34 billion* 52-week bills $61 billion* 5-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on January 28 $35 billion* 8-week bills for auction on January 28 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $28 billion* 2-year FRNs	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $62 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction February 1 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills	**SETTLE:** $15 billion 10-year TIPS
1	2	3	4	5
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $24 billion 20-year bonds $28 billion* 2-year FRNs $60 billion* 2-year notes $61 billion* 5-year notes $62 billion* 7-year notes	**ANNOUNCE:** $30 billion* 4-week bills for auction on February 4 $35 billion* 8-week bills for auction on February 4 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**ANNOUNCE MID-QUARTER REFUNDING:** $58 billion* 3-year notes for auction on February 9 $41 billion* 10-year notes for auction on February 10 $27 billion* 30-year bonds for auction on February 11	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction February 8 **SETTLE:** $105 billion* 13-,26-week bills	

**Estimate*